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C O N F I D E N T I A L SECTION 01 OF 02 ROME 000452

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TAGS: ETRD PREL IR IT
SUBJECT: ITALY-IRAN ECONOMIC RELATIONS

REF: A. ROME 329
¶B. 05 ROME 1807

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Classified By: Acting EcMin Richard Boly for reasons 1.4 (b) and (d)

¶1. (U) Summary: Italy is Iran's largest EU trading partner, with two-way trade totaling 2.91 billion euros in the first seven months of 2005, including 1.32 billion euros of Italian exports to Iran. Italy imports Iranian oil and gas and exports automobiles and electrical products to Iran. End Summary.

Italy: Slow Economy Dependent on Foreign Oil and Gas...
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¶2. (U) Italian economic growth since the late 1990's has been anemic. Since 2000, annual growth in Italian GDP has averaged 0.74 percent. GDP growth in 2005 was 0.2 percent, with 1.2 percent GDP growth projected for 2006. The high cost of energy is a factor impeding economic growth. One megawatt-hour of electricity costs between 60 and 80 euros in Italy, compared to an average of 40 to 60 euros in Germany and the UK. Similarly, the price of natural gas in Italy is about 20 percent higher than the European average. A disruption of oil or gas imports, especially one more sustained than last month's disruption of Russian natural gas deliveries, would likely cause energy prices to skyrocket, creating a further drag on Italy's already stagnant economy.

¶3. (U) Three quarters of Italy's electricity is generated using oil or gas. In the last decade, the portion of electricity produced from gas doubled from 20 percent to 40 percent, while electricity from oil decreased from 48 percent to 32 percent. Because Italy extracts domestically only ten percent the gas it uses, the increase in electricity generated using natural gas was made possible by increased imports and investments in more efficient gas-fired power plants. Although the importance of oil in generating Italy's electricity has declined, in 2004, Italy still imported 191,000 barrels of oil a day from Iran, which represents nine percent of Italy's total oil needs.

¶4. (U) Italy's dependence on foreign oil and gas is long-term. Alternate sources of electricity are few and far off. Several liquefied natural gas (LNG) projects are under construction, most notably one in the north Adriatic. Construction of these pipelines is expensive and has been slowed by local Italian governments' resistance. Additionally, as reported Ref B, there have been calls in

Italy to switch to nuclear power. This energy source, too, is a long way off; building a power plant can take more than ten years, and the political barriers are formidable.

...With A Correspondingly Large Investment in Iran
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¶5. (U) Recognizing the importance of the Italy-Iran economic relationship and of Iranian oil to the Italian economy, the GOI has taken steps to facilitate Italian investment in Iran. In 2005, following the meeting of the Seventh Joint Economic Commission between the two countries, the GOI and the Iranian government signed an MOU to increase cooperation in the areas of "extraction, production, and energy transfer (oil, gas, and electricity), and transfer of technology" between the two countries. The signing of the MOU underscores Italy's interest in the Iranian energy sector, in which Italian companies have already invested substantial amounts of money.

Petroleum-related investments - ENI, Snamprogetti, and Saipem
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¶6. (U) The Italian oil and gas conglomerate ENI has operated in Iran for fifty years, and is the largest foreign upstream investor in Iran. ENI has 2.5 billion dollars invested in Iran and receives 9,000 barrels of oil a day. Most recently, ENI purchased a 60 percent stake in the Darquain oil field, and is expected to invest 329 million dollars over the life of the oil field. In the Darquain deal, ENI signed a "buy back" contract with the National Iranian Oil Company (NIOC) under which ENI will receive about 22,000 barrels of oil a day by 2007 in return for its investment. ENI CEO Paolo Scaroni told the press that the deal "represents a further step in consolidating ENI's presence in the country and the profitable collaboration with Iran's authorities." Other ENI

investments include a 45 percent interest in the Dorrod oil field, a 38 percent interest in the Balal oil field, and a 60 percent interest in phases four and five of the development of South Pars gas field, the world's largest.

¶7. (U) The construction and engineering firms Snamprogetti and Saipem have also worked for the NIOC on various projects including refineries in Shiraz and Tabriz, the Marun-Isfahan oil pipeline, and the Muran-Isfahan-Rey oil pipeline pumping system. Snamprogetti also supplied the engineering services for the Iranian Gas Trunkline project, the Bandar Abbas Refinery, a petrochemical plant in Arak, and a Linear Alchyl Benzene (LAB) plant in Isfahan.

Fiat's 2005 Non-Petroleum Investment

¶8. (U) In January 2005, Fiat signed a partnership deal with Pars Industrial Development Foundation (PIDR) to produce cars at a plant near Tehran. Fiat's investment is 200 million euros. The plant is eventually expected to produce 250,000 cars annually. Access to the Iranian market is an important source of revenue for the struggling Fiat, which is emerging from bankruptcy and made a profit in the last quarter of 2005 for the first time in two years.

¶9. (C) Ministry of Productive Activities Director General for Energy and Mineral Resources, Sergio Garribba, told Econoff that doing business in Iran is difficult because of the role of the ruling Mullahs in all government activities, high levels of corruption, and the Iranian fondness for long, complex, and difficult negotiations. Garribba noted that the difficult terms the Iranians imposed on foreign investors, their refusal to allow equity investment by foreign companies, and the uncertainty inherent in investing in Iran, all make it difficult to predict returns on investments.

(C) Comment: Investments and Sanctions

¶10. (C) It is not clear what impact Italy's ties to the Iranian oil sector will have on Italy's support of possible economic sanctions against Iran. FM Fini has expressed support for political sanctions and maintains that the GOI supports the USG "100 percent" on referring Iran to the UN Security Council. However, such statements must be viewed in the context of Fini's desire to woo voters to his party in the April 9 national election as well as the negative effect economic sanctions against Iran would have on the Italian economy. Given the GOI desire, reported Ref A, to be included in meetings regarding Iran's nuclear program, such as those held in London at the end of January, and Italy's relative wealth of experience negotiating with Iran, we should continue to engage the GOI on this issue as we did in the January 30 meeting between U/S Burns and MFA DG Terzi. End comment.
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